



OFFICE OF THE GROUP CHIEF EXECUTIVE OFFICER

8 August 2025

Committee Secretary
Senate Economics Legislation Committee
Department of the Senate
Parliament House
Canberra, ACT AUSTRALIA
By email: economics.sen@aph.gov.au

Dear Secretary,

RE: Pacific Banking Guarantee Bill 2025

Thank you for the opportunity to contribute to the Senate Economics Legislation Committee inquiry into the Pacific Banking Guarantee Bill 2025.

Bank South Pacific (BSP) welcomes and supports the Australian Government's objective to maintain banking services in the Pacific. As the largest bank in Papua New Guinea and across the South Pacific, BSP shares similar goals and is committed to improving lives across the Pacific through financial inclusion, economic growth, and customer experience.

However, in its current form, the Pacific Banking Guarantee (PBG) risks creating competitive distortions and diminishing the presence of local banks such as BSP.

BSP has significant concerns about the current Bill and recommends amendments be made to:

- broaden the guarantee's availability to local and regional South Pacific banks, such as BSP, which have close ties to Australia and extensive operations in the South Pacific but are not headquartered domestically; and
- tighten its scope, to achieve the objective of ensuring an ongoing presence of Australian banks in the South Pacific, while minimising any adverse, offsetting impacts on regional economies and local banks, as well as risks to the Commonwealth balance sheet.

- Require that any future guarantees issued involve a consultation stage with local Pacific banks, to ensure a proper understanding of the local market and potential risks associated with the issuance of government-backed guarantees

Attached to our submission is economic analysis conducted by Lateral Economics of the PBG's competitive impacts on BSP to support our recommendations.

BSP's role in the South Pacific and ties to Australia

BSP is the largest and most widespread bank in the South Pacific region, with approximately 2 million customers, 4,600 staff and operations across Papua New Guinea (PNG), Fiji, Solomon Islands, Samoa, Tonga, Cook Islands, and Vanuatu.

Australian banks have largely exited South Pacific operations, with assets and branches often acquired by BSP.

BSP now accounts for approximately half of total deposits (52% share) and lending (49% share) in the South Pacific, with the closest competitor, ANZ, accounting for 16-17% of deposits and lending.

BSP market shares by country

	Lending		Deposits	
	Market share	Ranking	Market share	Ranking
PNG	61.2%	1	63.3%	1
Solomon Islands	40.1%	1	55.5%	1
Cook Islands	37.3%	2	46.6%	1
Samoa	33.7%	1	42.1%	1
Tonga	33.1%	1	39.9%	1
Fiji	27.1%	1	25.8%	1
Vanuatu	13.7%	3	13.8%	4

Source: BSP, Full Year Results 2024 Investor Presentation.

This market share is supported by the largest branch network in the South Pacific with 120 branches and the widest digital banking infrastructure in the region.

BSP has already made significant investments in digital banking and, as part of our 'Modernising for Growth' agenda, we have embarked on an additional A\$250 million investment into technology, digital channels and operational resilience to support access to banking services in the South Pacific. BSP makes this investment without the assistance of any government support or guarantee.

BSP serves South Pacific communities via an extensive network of over 120 branches, many of them supporting regional and remote communities. BSP has maintained this branch footprint whilst other banks exit the region, and is committed to ensuring South Pacific nations are able to access financial services including cash.

BSP also has strong ties to Australia and Australian heritage, including

- Dual listing on the ASX and PNGX;
- Australian heritage – our roots date back to 1916 when the Commonwealth Bank established a presence in Port Moresby
- The 2015/2016 acquisition of Westpac operations in the Pacific; and
- Strong relationships with Australian banks – correspondent banking with CBA and NAB.

BSP is 97% owned by South Pacific investors, including super funds, land-owning companies and churches, and is a critical financial institution driving financial inclusion, economic stability and community development across the South Pacific.

BSP also plays a pivotal role in supporting fiscal stability and infrastructure development across the South Pacific region through significant investments in government bonds issued by regional governments. For example, BSP holds a significant portion of PNG government bonds as part of its asset portfolio.

Economically, BSP has a substantial impact on the region, with assets totalling approximately A\$13.7 billion and a market capitalisation of A\$4 billion on the ASX.

The bank's contribution to national economies is substantial; BSP paid approximately A\$1 billion in corporate taxes over the last five years, and approximately 17% of PNG's non-resource corporate tax revenue in 2024.

Moreover, BSP's dividend payments—approximately A\$1.5 billion over the past five years—benefit major institutional shareholders across the Pacific, thus supporting the broader financial ecosystem.

Adverse impacts on the market share and financial position of local Pacific banks

In implementing the PBG, BSP understands the Australian Government has extended an initial 10-year guarantee to ANZ to support its presence in the Pacific. While the specific terms have not been disclosed, we understand that the guarantee reduces regulatory capital requirements for eligible banks' Pacific operations – a benefit not extended to locally based Pacific banks such as BSP which are not headquartered in Australia.

We are concerned that the guarantee distorts the competitive landscape, risks crowding out locally owned institutions, and ultimately may disadvantage the 12 million Pacific Islanders who are the ultimate beneficiaries of BSP through local superannuation funds, religious institutions, and public investors.

The government guarantee could allow banks receiving the guarantee to adopt a more aggressive market stance, which could jeopardise BSP's competitiveness and threaten its substantial market investments in key Pacific markets and its contribution to regional economic development.

Australian Government guarantees may also enable recipients to utilise the actual or perceived benefits of being backed by the Australian Government in marketing efforts in the Pacific, providing them with a competitive advantage unable to be met by local banks.

In Pacific markets, Australian banks are already lending at highly competitive rates compared with local banks. This highlights the significant cost advantage that Australian banks already have relative to local banks in the South Pacific, which will be compounded further with the introduction of the PBG.

The loss of market share to Australian domiciled banks as a result of the PBG and the resultant loss of profits will have significant adverse effects on the local Pacific banks which cannot participate in the scheme.

Lateral Economics modelling indicates a lower bound impact on market share of a loss of 4 percentage points of market share and an upper bound impact loss of over 17 percentage points due to the effect of the PBG lowering the cost of finance for competitors. In terms of impact on BSP's

financial position, modelling indicates a reduction in earnings of up to A\$40 million annually.¹

Indirect economic and social impacts

There is also a risk that guarantees to Australian domiciled banks may inadvertently delay the emergence of more resilient local credit ecosystems in the South Pacific. The significant, external support provided through the PBG risks undermining local institutions.

Foreign guarantees also risk ‘crowding out’ the development of more creditworthy lending practices by offering artificially low-cost capital to external actors without commensurate accountability to the domestic financial environment. The OECD has observed that financial guarantees by development banks or donor countries can create “capital market distortions, crowding out other sources of capital in “unfair” ways, and the disturbance to existing market relationships”.

There are also potentially adverse impacts on regional governments and the broader community if the viability of local banks is threatened and they need to reduce their workforces, particularly if their impacted corporate lending operations are cross-subsidising other parts of their businesses.

Further, BSP and other local banks have extensive holdings of PNG government bonds. To the extent these local banks are adversely impacted, a reduction in demand for local government bonds by local banks would result in lower bond prices and higher borrowing costs for the government and most other borrowers whose interest payments are likely to be set by reference to government borrowing rates.

Concerns with the guarantee’s design

The current Bill conveys a very broad power to guarantee the banking activities of Australian banks within a wide geographical scope. As it stands, the PBG is likely to have unintended consequences, including the potential for market distortion, and thus a detrimental impact on Pacific communities and institutions.

We have specific concerns with the following features of the PBG:

- a) the open-ended appropriation for a broad, uncapped guarantee;

¹ See Attachment A: Lateral Economics – Economic Impacts of the Pacific Banking Guarantee, pg. 26.

- b) the lack of a defined fee or articulation of principles by which a fee could be set that is commensurate with the risk the Commonwealth is taking on its balance sheet;
- c) the adverse impacts on South Pacific banks, which are important contributors to regional economies and significant lenders to regional governments and their economies through their holdings of public debt;
- d) the terms of individual guarantee agreements are confidential, making it difficult to understand and quantify the potential impacts. For example, it is unclear whether the fee is for the guarantee or whether there is a fair exchange of value between the bank and the Commonwealth

Recommendations to improve the guarantee and mitigate risk

BSP recommends the definition of 'Pacific banking guarantee' in the Bill be broadened to allow ADI's headquartered outside of Australia to be eligible to be granted a guarantee.

The current restriction at section 5(2)(c) which requires an ADI subject to a guarantee to have its headquarters located in Australia excludes local Pacific banks, like BSP, from accessing a PBG.

The design of the PBG legislation should be amended to ensure a level playing field and support to the banks offering services and investing in the Pacific Region. As it does on other aspects of the guarantee, such as the guarantee value and duration, the Commonwealth should have broader discretion and flexibility in relation to the ADI's it grants guarantees to.

Despite BSP's profile as the main bank servicing the Pacific and being listed in Australia, the PBG will not be available, and the bank will face market distortions due to competitors not being subject to the same capital pressures. Economic modelling indicates this will directly impact BSP's market share and financial position.

BSP also recommends a consultation requirement be added to the Bill in relation to the granting of future PBG's. This requirement will ensure competing banks in the region are able to respond to a guarantee proposal and prepare for the competitive pressure of competing banks in the region being underwritten by Australian taxpayers. BSP is unaware of any consultation undertaken with local Pacific bank/s in relation to the PBG legislation and announced guarantee for ANZ.

In addition to broadening eligibility for the PBG and mandating consultation, BSP supports the recommendations made by Lateral Economics including tightening the scope of the guarantee's operation to achieve its objectives while minimising any adverse, offsetting impacts on local banks, regional economies and risks to the Commonwealth balance sheet.

Thank you for the opportunity to make this submission and we look forward to ongoing engagement with the committee.

For any further information to support the inquiry, please contact

Yours sincerely

Mark T. Robinson

Chief Executive Officer

Bank South Pacific

Attachment A: *Lateral Economics – Economic Impacts of the Pacific Banking Guarantee*

Economic Impacts of the Pacific Banking Guarantee

A Lateral Economics report to
Bank South Pacific

August 2025



LateralEconomics

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Abbreviations

ADI	Authorised Deposit-taking Institution
AML	Anti-money laundering
ASX	Australian Securities Exchange
bps	Basis points
BSP	Bank South Pacific
CTF	Counter-terrorism financing
FATF	Financial Action Task Force
FY	Financial year
GDP	Gross Domestic Product
IMF	International Monetary Fund
LE	Lateral Economics
NIM	Net interest margin
NPAT	Net profit after tax
PBG	Pacific Banking Guarantee
PNG	Papua New Guinea
PNGX	PNG's National Stock Exchange
RBA	Reserve Bank of Australia
SME	Small and medium enterprises



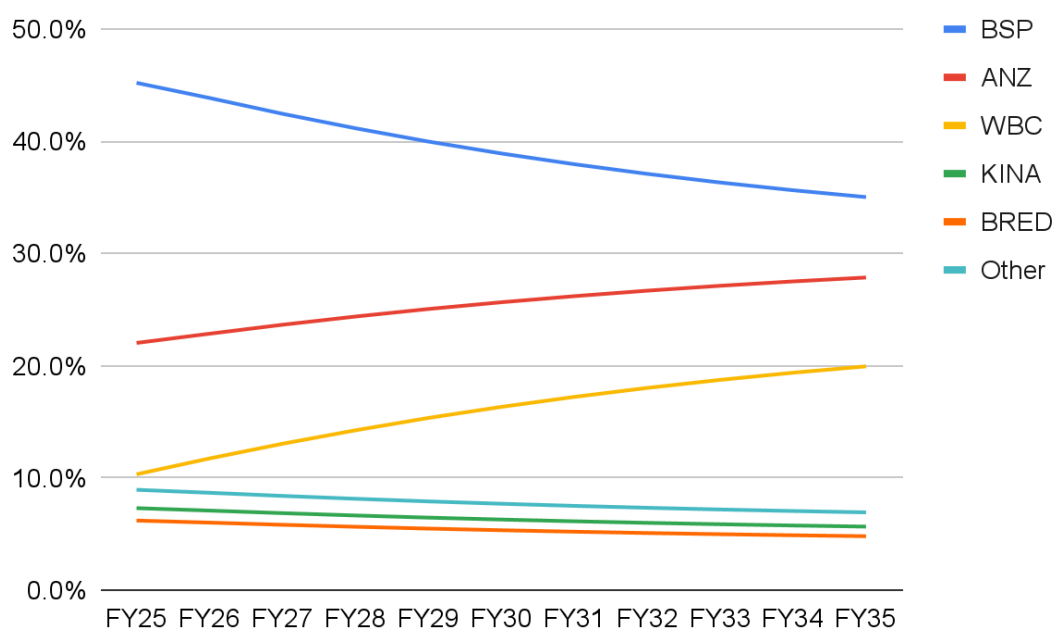
Executive summary

The Australian Government's proposed Pacific Banking Guarantee (PBG) aims to maintain the presence of Australian banks in the Pacific region by giving the Commonwealth the power to guarantee the Pacific banking activities of Australian banks. This report examines the potential competitive distortions and reductions in the market shares of local banks like Bank South Pacific (BSP) that the PBG could introduce.

Adverse impacts on the market shares of local banks

By conveying a competitive advantage to Australian banks, the PBG risks Australian banks using it to significantly expand their market shares in Pacific markets at the expense of local banks such as BSP and Kina Bank. In our central (medium-range) modelling scenario, where both ANZ and Westpac leverage the guarantee, their combined market share would substantially increase, notably impacting BSP the largest local bank. Specifically, BSP could face a reduction of 9 percentage points in its market share, significantly affecting its profitability. BSP's loss of market share ranges from under 4% in our lower-bound scenario to over 15% in our upper-bound scenario.

Figure A. Impacts on market shares, medium-range scenario



Fiscal risks to the Australian Government

The PBG is attractive to the Commonwealth from a budgetary perspective because the risk is a contingent liability, and it earns some revenue from charging for the guarantee. However, depending on the extent to which the fees reflect the actual risks of guaranteeing the lending, the proposed PBG carries material risks to the Commonwealth government's balance sheet, given that it would represent an additional contingent liability alongside existing guarantees, such as the Home Guarantee Scheme (HGS), and Australia's already substantial debt obligations.

Introducing another guarantee expands the government's exposure, potentially straining fiscal capacity in times of economic stress. These risks are magnified by the inherent vulnerabilities in the South Pacific region, particularly in Papua New Guinea, where political instability, weak governance structures, and susceptibility to economic shocks increase the likelihood of banks requiring financial assistance under the guarantee. Consequently, the government must carefully weigh the strategic benefits of regional financial stability against the fiscal risks associated with compounding contingent liabilities.

Indirect economic and social impacts through PBG's impacts on BSP

As the dominant local bank, BSP plays a crucial role in the economic stability and growth of South Pacific nations. BSP is recognised as the largest financial institution in the Pacific, holding significant market shares across several countries, including Papua New Guinea, Fiji, the Solomon Islands, Tonga, Samoa, the Cook Islands, and Vanuatu. Its systemic importance is evident through its employment of over 4,600 staff members, as well as its notable contributions to GDP, corporate taxes, and dividends. Additionally, BSP makes substantial community investments and sponsorships that positively impact the regions it serves.

Given this, it is crucial to recognise BSP's role in fostering economic resilience and inclusion. BSP has made significant contributions to regional economic stability and growth by implementing extensive digital banking initiatives and providing targeted financing for small and medium enterprises (SMEs). The innovative "Wantok Wallet" further enhances this effort by significantly expanding financial inclusion for underserved communities.

The Guarantee could disadvantage BSP's many local stakeholders. BSP significantly benefits Pacific Islanders through major institutional shareholders, including national provident funds, superannuation funds, and religious institutions—ultimately benefiting 12 million Pacific Islanders.



Mitigating the risks

To mitigate these risks, several policy adjustments are recommended. These include explicitly limiting the guarantee exposure through capped appropriations and clearly defined timelines. Additionally, it is essential to establish transparent and appropriate fees (of at least 100 basis points) that reflect the actual risk to the Commonwealth and reduce moral hazard. Introducing risk-sharing mechanisms whereby banks bear a portion of any potential losses—similar to an insurance excess—would promote prudent lending practices.

Conclusion

In conclusion, while the PBG seeks to preserve Australian banking presence and regional stability, its current structure risks significant competitive imbalance and fiscal stress.



1. Introduction

Bank South Pacific (BSP) has engaged Lateral Economics (LE) to undertake economic analysis of the competitive impacts on BSP from the proposed Pacific Banking Guarantee (PBG) by which the Australian Government seeks to support the presence of Australian banks in the Pacific. BSP is concerned about the competitive implications of the ten-year guarantee provided by the Australian Government to ANZ, which may distort competition and create an uneven playing field in Pacific banking markets. It is expected that the guarantee will reduce ANZ's regulatory capital requirements for its Pacific operations. Access to the guarantee will not be extended to locally based Pacific banks such as BSP. The government guarantee could allow ANZ to adopt a more aggressive market stance, which may jeopardise BSP's competitiveness and threaten its substantial market shares in key Pacific markets and its contribution to regional economic development. This risk rises if the guarantee to ANZ is extended to other Australian banks.

This report presents LE's analysis of the PBG, including both quantitative and qualitative assessments. It is structured as follows:

- Section 2 presents key background information on South Pacific banking markets and the proposed PBG;
- Section 3 presents LE's economic modelling of the PBG; and
- Section 4 discusses the implications of the analysis and outlines key policy considerations.

2. Background

2.1. South Pacific banking markets

2.1.1 Size, scope and leading players

The major banks operating in the South Pacific region include a mix of regional Pacific banks and large Australian institutions. The principal players include:

- **Bank South Pacific (BSP):** The largest and most widespread bank in the region, BSP has operations in Papua New Guinea (PNG), Fiji, Solomon Islands, Samoa, Tonga, Cook Islands, and Vanuatu and enjoys a market share of over 25% in six of the seven countries, especially after acquiring Westpac's operations in several of these countries.

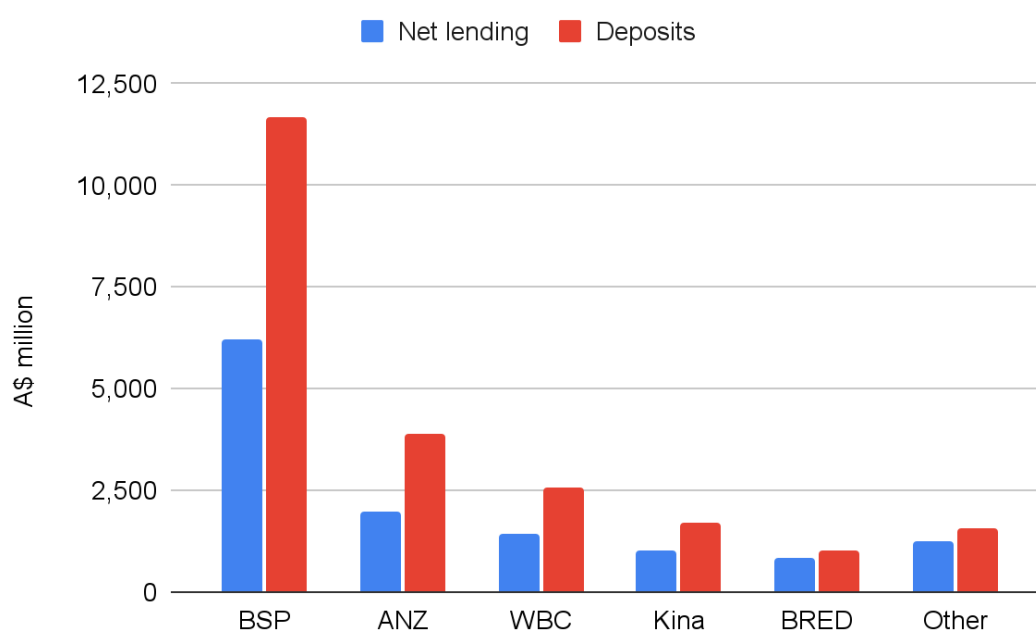


Its market share ranges from a low of 13-14% in Vanuatu to a high of 61-63% in PNG for lending and deposits, respectively.¹

- **ANZ (Australia and New Zealand Banking Group):** ANZ maintains a strong presence in Fiji and retains operations and payment channels across the region, albeit scaled back in several countries after past sales and rationalisations. ANZ was historically one of the biggest players and is still influential in markets such as Fiji and Solomon Islands.
- **Westpac:** Historically active throughout the South Pacific, Westpac remains one of the oldest banks continuously operating in PNG and Fiji, after selling its operations in Samoa, Cook Islands, Solomon Islands, Vanuatu, and Tonga to BSP in recent years.

BSP accounts for approximately half of total deposits (52% share) and lending (49% share) in the South Pacific (Figure 2.1), with its closest competitor, ANZ, accounting for 16-17% of deposits and lending.

Figure 2.1. Market shares of South Pacific banks, 2022-23



Source: BSP, 2025.

BSP has its largest market shares in PNG, with smaller market shares in other Pacific economies where other banks have a significant share—e.g. ANZ in Fiji (Table 2.1).

Nonetheless, BSP has the largest market share for lending in all South Pacific markets except

¹ BSP (2025) BSP Full Year Results 2024 Investor Presentation, p. 7.



for Cook Islands and Vanuatu, and the largest market share for deposits in all markets except for Vanuatu.

Table 2.1. BSP market shares by country

	Lending		Deposits	
	Market share	Ranking	Market share	Ranking
PNG	61.2%	1	63.3%	1
Solomon Islands	40.1%	1	55.5%	1
Cook Islands	37.3%	2	46.6%	1
Samoa	33.7%	1	42.1%	1
Tonga	33.1%	1	39.9%	1
Fiji	27.1%	1	25.8%	1
Vanuatu	13.7%	3	13.8%	4

Source: BSP, Full Year Results 2024 Investor Presentation.

Other notable banks that operate in select South Pacific countries include Bank of Baroda, BRED Bank (a French banking group with presence in Fiji and Solomon Islands), and several smaller, locally focused commercial and development banks such as the National Development Bank in PNG, Pan Oceanic Bank in the Solomon Islands, National Bank of Vanuatu, National Bank of Samoa. Australian banks like Commonwealth Bank and NAB have largely exited direct Pacific operations, with assets and branches often acquired by BSP or local entities.

2.1.3. Correspondent banking and potential grey listing

As with other banks globally, South Pacific banks rely on correspondent banking relationships (Box 2.1). The withdrawal of correspondent banks from the South Pacific is one of the motivations for the Pacific Banking Guarantee Bill. By guaranteeing lending in the Pacific, the Australian Government aims to maintain the Pacific presence of Australian banks, which have well-established correspondent banking relationships globally.

In the second reading speech for the bill on 24 July, the Assistant Treasurer and Minister for Financial Services noted, “We know the Pacific has seen the fastest withdrawal of correspondent banking services of any region in the world.” The Reserve Bank of Australia (RBA) reported that the number of active correspondent banks in the South Pacific decreased by about 60% between 2011 and 2022.² This decline was nearly twice the global rate of decline in correspondent banking, raising concerns about the ongoing accessibility and affordability of cross-border banking services in the region. The decline is due partly to a desire by

² Davies, Michael (2023) “Correspondent Banking in the South Pacific”, RBA Bulletin, June 2023, p. 84.



international banks to 'de-risk' following the 2008 financial crisis and by concerns over the anti-money laundering and counter-financing of terrorism (AML/CTF) compliance of regional institutions.³

Box 1. Correspondent banking: Key Concepts and Functions

Correspondent banking involves one bank, known as the correspondent, providing financial and banking services on behalf of another bank, the respondent, typically across international borders. This arrangement allows banks to offer services and execute transactions in jurisdictions where they lack a direct physical presence.

Correspondent banks offer core services including the clearing and settlement of cross-border payments, foreign exchange and trade financing, as well as cash management, liquidity support, and transaction processing.

The system plays a vital role in international finance, supporting global trade, international remittances, and cross-border investment flows. It enables smaller and regional banks to access international financial markets and infrastructure, thereby enhancing global economic integration.

An illustration of correspondent banking relationships was given by the federal member for Cowper in the Australian Parliament on 30 July 2025:

“...a construction business in Tonga might import building equipment from Brisbane. Because their local bank doesn't have a direct link to Australian banks, a larger institution, like ANZ, steps in to process the international payment.”⁴

Correspondent banking relationships are widespread and form the backbone of international financial transactions. They are particularly crucial in emerging markets and regions such as Africa, Asia, and Latin America. Local banks in these areas often rely heavily on correspondent relationships with larger global banks, predominantly located in North America and Europe, to facilitate international trade and financial flows.

However, correspondent banking also presents risks and challenges, notably increased compliance risks associated with Anti-Money Laundering (AML) and Counter-Terrorism Financing (CTF) regulations. Recent regulatory tightening has led to major banks

³ Boulton, Lindsay and Brett Winton (2018) “Developments in Correspondent Banking in the South Pacific”, RBA Bulletin, June 2018, p. 3.

⁴ Mr Conaghan MP, Member for Cowper, House of Representatives Hansard, Wednesday 30 July 2025, p. 34.



"de-risking," by reducing their correspondent relationships. This has disproportionately affected financial institutions in developing countries, limiting their access to the global financial system.

As the RBA has noted:

"Correspondent banks are important for all countries, but they can be particularly vital in smaller open economies. These economies often rely heavily on foreign currency inflows, such as remittances to households, official development assistance and tourism receipts. Their local banks are often relatively small or do not have offices abroad to offer cross-border payment services themselves. In these situations, international banks offer account services – 'correspondent banking services' – to local banks".⁵

There is a risk that PNG's financial system will be grey-listed by the Financial Action Task Force (FATF), the international watchdog for money laundering and terrorism financing. This would increase international scrutiny of PNG's financial transactions, potentially leading to reduced investor confidence, higher transaction costs, delays in international banking, and significant obstacles to foreign investment and economic development. This could severely reduce foreign investment and constrain major resource-related projects, critical to PNG's economic growth. PNG was already grey-listed in 2014, and this was only removed in 2016 after extensive legislative reforms. A recurrence could damage its international economic reputation and create significant barriers to financial and economic activity.

The RBA has identified the following risks to South Pacific economies from a reduction in access to correspondent banking:

1. increased cost of cross-border payments and remittances;
2. greater use of informal payment systems, including physically transporting cash, Hawala, and cryptocurrencies;
3. heightened financial fragility by increasing the operating costs of local banks.⁶

The withdrawal of correspondent banks from the Pacific is more of a threat to the smaller banks than to BSP, which has well-developed correspondent banking relationships with National Australia Bank and the Commonwealth Bank in Australia and Bank of America and Wells Fargo in the US. Nonetheless, it is not entirely free from risk, and it needs to ensure tight compliance with AML-CTF regulations to maintain its correspondent banking relationships.

⁵ Davies, Michael (2023) "Correspondent Banking in the South Pacific", RBA Bulletin, June 2023, pp. 82-83.

⁶ Ibid., p. 86.



As of July 2025, PNG has not been officially grey-listed by the FATF, but is anticipated to face grey listing by late 2025 or early 2026 unless rapid improvements are made. PNG is currently under a 12-month observation period, concluding in October 2025, during which it must demonstrate significant progress in addressing deficiencies in its anti-money laundering and counter-financing of terrorism (AML/CTF) frameworks (Box 2.2). Despite government efforts through a National Coordination Committee and a multi-agency AML Task Force, experts—including the Bank of PNG—believe sufficiently comprehensive reform by the deadline is unlikely, making grey listing highly probable.

Box 2.2. Anti-money laundering (AML) and counter-terrorism (CTF)

Anti-Money Laundering (AML) and Counter-Terrorism Financing (CTF) frameworks are critical regulatory systems designed to detect, prevent, and mitigate financial crimes. AML frameworks seek to reduce economic crimes such as fraud, corruption, and tax evasion by preventing criminals from disguising illegally obtained funds as legitimate income. CTF frameworks specifically target the financing mechanisms used to fund terrorist activities, disrupting the flow of financial support to terrorist groups.

Effective AML/CTF frameworks typically encompass rigorous legislative and regulatory standards, thorough customer due diligence processes, regular monitoring and reporting of suspicious activities, and robust enforcement mechanisms. Internationally, bodies such as the Financial Action Task Force (FATF) establish standards and guidelines, assessing compliance through periodic evaluations. Countries failing to comply risk being grey-listed or blacklisted, facing increased scrutiny, higher transaction costs, and potential impediments to international trade and investment.

Grey listing indicates that a country has deficiencies in its AML/CTF frameworks requiring increased international monitoring. In contrast, black listing signals severe non-compliance, leading to stronger sanctions and significant restrictions on international financial transactions.

2.1.4. Economic and social contributions of major local banks

BSP is a critical financial institution driving financial inclusion, economic stability and community development across the Pacific region. As the largest financial institution headquartered in PNG, BSP maintains a dominant market presence, holding significant market



share in assets, loans, deposits, and profits across the region. Although it has a smaller level of activity than either ANZ or Westpac in the region, the second largest local bank, Kina Bank—provides substantial competition and contributes further diversity to the financial landscape, especially within PNG.

Economically, BSP has a substantial impact on the region, with assets totalling approximately A\$13.7 billion and a market capitalisation of A\$3.4 billion on the ASX and K9.9 billion on the PNGX in FY24. Its net profit after tax (NPAT) stood at A\$408 million, showcasing sustained profitability and robust financial health.⁷ BSP's significance is underscored by its extensive lending activities, being the largest lender in PNG, Fiji, Solomon Islands, Samoa, and Tonga.⁸

The bank's contribution to national economies is substantial; BSP paid around A\$1 billion in corporate taxes over the last five years, representing about 17% of PNG's corporate tax revenue in 2024. Moreover, BSP's dividend payments—approximately A\$1.5 billion over the past five years—benefit major institutional shareholders across the Pacific, including superannuation and provident funds, thus supporting the broader financial ecosystem.⁹

BSP plays a pivotal role in supporting fiscal stability and infrastructure development across the Pacific region through its significant investments in government bonds issued by regional governments. BSP holds a significant portion of PNG government bonds as part of its asset portfolio. According to recent analyses, more than half of BSP's total banking sector assets are held in government securities or cash. A 2024 IMF report states that commercial banks in PNG hold large amounts of government securities, with such holdings accounting for about 33% of total bank assets. The IMF remarked that, in PNG, the “Bank-sovereign nexus is high”.¹⁰

BSP actively contributes to community development and social responsibility. It employs more than 4,600 staff across the Pacific, providing critical employment and capacity-building opportunities. It has pioneered digital financial inclusion, processing over 20.2 million digital transactions monthly across the South Pacific. Its innovative product, the Wantok Wallet, launched in 2025, facilitates access to financial services without traditional bank accounts.¹¹

Community investments are integral to BSP's operations, with approximately A\$15 million invested over the last five years in sponsorships, donations, and community projects. These initiatives notably enhance financial literacy, SME financing, and digital education. Kina Bank

⁷ BSP Financial Group Limited (Bank South Pacific), May 2025.

⁸ BSP Full Year Results 2024, Investor Presentation, 24 February 2025.

⁹ BSP Financial Group Limited (Bank South Pacific), May 2025.

¹⁰ IMF (2024) Papua New Guinea: Technical Assistance Report-Financial Sector Stability Review, <https://www.elibrary.imf.org/view/journals/019/2024/103/article-A001-en.xml>.

¹¹ BSP Financial Group Limited (Bank South Pacific), May 2025.



complements these efforts through its own community and financial education initiatives, creating synergistic impacts on regional development.

Both banks have strong commitments to Environmental, Social, and Governance (ESG) principles. BSP's ESG materiality assessment identified five priority areas: financial health, addressing gender-based violence, workforce capability enhancement, improved corporate governance, and climate vulnerability mitigation. These ESG priorities guide BSP's strategic direction, enhancing its reputation and operational resilience.

In regulatory and policy spheres, BSP functions as a systemically important financial institution, actively engaging with regional policymakers to foster regulatory environments conducive to sustainable growth. Kina Bank also engages in advocacy and regulatory discussions, particularly in PNG, reinforcing financial sector stability and consumer protection.

2.2. Wider economic and political circumstances

The economy of the South Pacific faces significant vulnerabilities and development challenges. PNG is the largest economy, followed by Fiji (Table 2.1). All the South Pacific economies have relatively low per capita incomes.

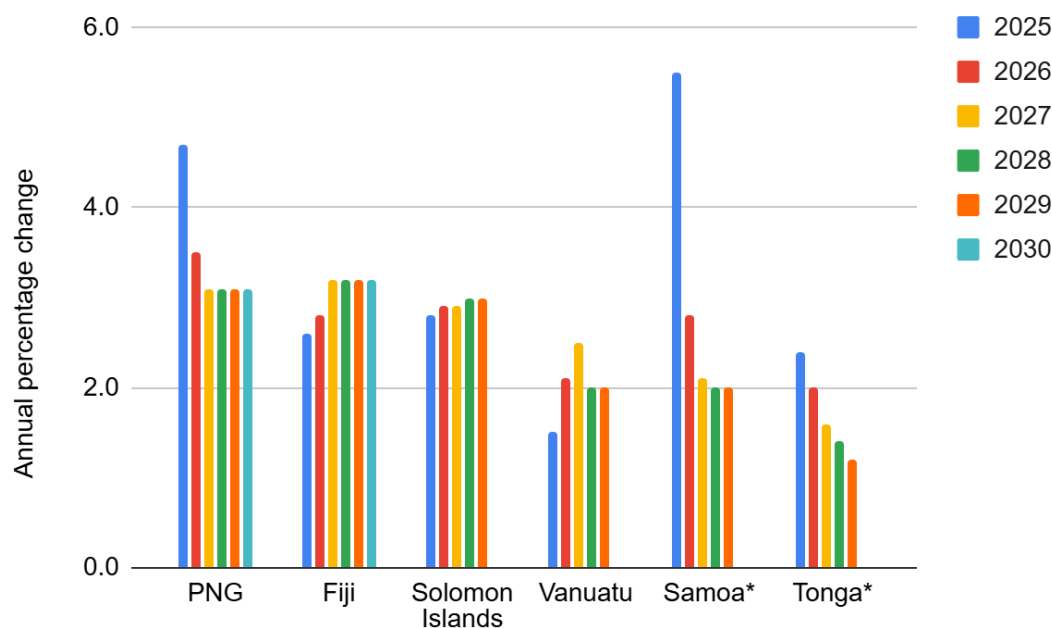
Table 2.1. Demographic and economic statistics, South Pacific economies

	Population ('000)	GDP, current prices (Billions of USD)	GDP per capita, current prices (USD dollars per capita)
Papua New Guinea	12,527.4	31.654	2,524
Fiji	897.3	5.949	6,447
Solomon Islands	769	1.777	2,269
Vanuatu	321.5	1.206	3,492
Samoa	208.6	1.068	5,070
Cook Islands	20.2*	-	-
Tonga	100.0	0.539	5,416

Source: IMF.

The IMF expects South Pacific economies to continue growing at reasonable but not high rates over the rest of the decade (Figure 2.1). This suggests an increasing requirement for lending, but not a large increase in the financing requirement. The strong result for Samoa in 2024-25 is related to public investment associated with the CHOGM conference, highlighting the small size of several Pacific economies.



Figure 2.1. IMF estimates & forecasts of real GDP growth rates

Source: The latest IMF Article IV reports for the South Pacific economies. *Financial year data.

Many Pacific Island countries heavily depend on sectors such as tourism, fisheries, and remittances, with external aid also being important. Geographic isolation, limited domestic markets, and frequent exposure to severe weather-related events, including cyclones and rising sea levels, severely constrain economic growth and resilience. Additionally, the region faces challenges in diversifying its exports and integrating effectively into global supply chains due to its small population size and physical remoteness.

Externally driven economic engagement has increased substantially in recent years, notably through China's Belt and Road Initiative, which has funded major infrastructure projects across the region. While these investments have provided critical infrastructure, concerns have arisen regarding debt sustainability and the potential for increased dependency.¹² Traditional partners, including Australia, New Zealand, the United States, and the European Union, continue to play significant roles through aid, trade, and investment, emphasising capacity building and institutional strengthening.

Politically, the South Pacific has become a focal point of strategic geopolitical competition, particularly between China and Western-aligned nations such as Australia, New Zealand, and

¹² Hariharan, Lochana (2025) "China's BRI and Solomon Islands: Pacific Perspective", Modern Diplomacy, <https://modern diplomacy.eu/2025/02/05/chinas-bri-and-solomon-islands-pacific-perspective/>.



the United States.¹³ Diplomatic and security tensions have intensified following developments such as the Solomon Islands-China security agreement, which raised alarm among the Solomon Islands' traditional regional allies.¹⁴

Finally, governance and institutional stability remain critical challenges within the region. Many Pacific Island countries grapple with governance issues, including corruption, transparency concerns, and political instability, often exacerbated by limited institutional capacity.¹⁵

In summary, the South Pacific, while growing, is not growing at a fast pace, and further presents significant risks related to institutional failures and geopolitical tensions. This needs to be borne in mind when considering the net benefits of the PBG to Australia.

2.3. Australian Government responses

2.3.1. Diplomacy and overseas development assistance

In response to the growing regional role of China, the Australian Government has significantly increased its diplomatic engagement and aid commitments to the South Pacific. Initiatives such as the Pacific Step-up strategy underscore Australia's focus on strengthening regional partnerships, economic cooperation, and security collaboration—although the Lowy Institute's Peter Layton has raised concerns that the plan is failing.¹⁶

Additionally, Australia has deepened regional security cooperation through agreements and partnerships aimed at enhancing maritime security, defence capacity-building, and disaster response capabilities. Initiatives like the Australian Infrastructure Financing Facility for the Pacific (AIFFP) are designed to address infrastructure needs while avoiding regional economies taking on burdensome debts.

Through these initiatives, Australia seeks to sustain regional stability, promote sustainable development, and maintain strong relationships with its Pacific neighbours.

¹³ Keen, Meg and Tidwell, Alan (2018) "Geopolitics in the Pacific Islands: Playing for advantage", Lowy Institute Policy Brief, <https://www.lowyinstitute.org/publications/geopolitics-pacific-islands-playing-advantage>.

¹⁴ Kabutaulaka, Tarcisius (2022) "China-Solomon Islands Security Agreement and Competition for Influence in Oceania", Georgetown Journal of International Affairs, <https://gija.georgetown.edu/2022/12/02/china-solomon-islands-security-agreement-and-competition-for-influence-in-oceania/>.

¹⁵ McDonald, Joshua (2021) "Is Corruption a Serious Problem in the Pacific?", The Diplomat, <https://thediplomat.com/2021/11/is-corruption-a-serious-problem-in-the-pacific/>.

¹⁶ Layton, Peter (2022) "Fixing Australia's failing Pacific Step-up strategy", The Interpreter, <https://www.lowyinstitute.org/the-interpreter/fixing-australia-s-failing-pacific-step-strategy>.



The PBG has been viewed by some commentators as partly motivated by Australia's strategic desire to maintain its influence in the South Pacific as China increases its regional relationships and investments.¹⁷

2.3.2. Pacific Banking Guarantee

Guarantee to ANZ

The Australian Government has agreed to provide a limited guarantee over the next ten years to ANZ in support of the bank's continued operations across the Pacific region. ANZ has a presence in Fiji, PNG, Samoa, Vanuatu, Tonga, Solomon Islands, Timor-Leste, Kiribati, and the Cook Islands. By providing the guarantee, the Australian Government seeks to support Australia's strategic engagement in the region and ANZ's continued provision of secure and accessible banking services.

Under the terms of the agreement, the Government will guarantee ANZ's Pacific operations for ten years, with the maximum exposure under the guarantee capped at \$2 billion. The Government has assessed the likelihood of the guarantee being called upon as very low. ANZ will pay an annual fee to the Government as part of the arrangement. This fee has not been disclosed. It was not disclosed whether there is any excess amount—i.e. losses ANZ has to bear before the PBG applies.

Existing information on the PBG is unclear regarding whether it is meant to apply only to existing lending, new lending only, or both. The phrase "current Pacific operations" used in ANZ's media release could reasonably be interpreted to include both existing and future lending activities as part of ANZ's ongoing business in the region.¹⁸

As part of the arrangement with the Australian Government, ANZ will invest a further \$50 million to improve its digital banking platforms and overall service delivery in the region. This investment will support infrastructure upgrades and the continued availability of financial services, including the bank's fee-free international money transfer services through its retail digital channels. These services have been a key mechanism for facilitating remittances into the Pacific, which are an important source of household income and economic stability across several island nations.

¹⁷ Keene, Matthew, Nitin Gupta, Jaan Murphy (2025) "Pacific Banking Guarantee Bill 2025", Bills Digest No. 52, 2024-25, https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd2425/25bd052.

¹⁸ <https://www.anz.com.au/newsroom/media/2025/march/Update-regarding-ANZs-Pacific-operations/>



Incidentally, in March 2025, ANZ announced that it was “setting aside AUD\$1 billion over the next 10 years to finance investment in Pacific infrastructure projects, subject to ANZ’s standard risk criteria.”¹⁹

Pacific Banking Guarantee Bill 2025

The PBG is expected to commence in the second half of 2025, subject to the passage of enabling legislation, the *Pacific Banking Guarantee Bill 2025*.²⁰ This is a short bill that provides an uncapped appropriation from the Consolidated Revenue Fund (in section 5) relating to:

- a guarantee from the Commonwealth, which the Commonwealth has broad powers to grant under section 60 of the *Public Governance, Performance and Accountability Act 2013*²¹; to
- Australian-headquartered Authorised Deposit-taking Institutions (ADIs), i.e. banks, as defined under the *Banking Act 1959*, for any banking business they do in the Pacific; where:
- the Pacific is defined in section 3 of the bill as:
 - the islands of the Pacific (which are not further defined);
 - PNG; and
 - Timor Leste.

In other words, it conveys a very broad power to guarantee the banking activities of Australian banks within a wide geographical scope. We discuss how tightening the guarantee power granted by the bill is desirable in section 4.

3. Economic impacts of the Pacific banking guarantee

3.1. Scenarios

We model two different scenarios regarding the PBG:

- Scenario 1: take-up by ANZ only, and only up to its announced commitment of \$1 billion of new investment in Pacific infrastructure projects; and
- Scenario 2: take-up by ANZ and another Australian bank (e.g. Westpac), which will also lend \$1 billion over the next ten years.

¹⁹ <https://www.anz.com.au/bluenotes/2025/march/stubbings-pacific-australian-government-guarantee/>

²⁰ https://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r7341_first-reps/toc_pdf/25038b01.PDF

²¹ <https://www.legislation.gov.au/C2013A00123/latest/downloads>



In both scenarios, the Australian bank or banks are expected to use the guarantee for new business lending. This is based on the market expectation discerned from our industry consultation.

3.2. Methodology

To assess the impacts of the guarantee on existing banks in the South Pacific, we need to distinguish between:

1. genuine additional lending due to lower borrowing costs or additional risk-taking by the guaranteed lenders—some of which may be related to moral hazard (refer to section 4.1); and
2. and substitution from lending that existing banks would have done.

3.2.1. Additional lending

The amount of additional lending in year t , ΔL_t , is calculated according to equation 1.

$$\Delta L_t = (r_{Pac} - r_{Aus}) \times \eta \times L_t (1)$$

where

- r is the (real) borrowing rate;
- the subscript 'Pac' denotes the borrowing rate offered by Pacific banks not covered by the PBG, and the subscript 'Aus' denotes Australian banks covered by the PBG; and
- η denotes the elasticity or sensitivity of new lending to the borrowing rate.

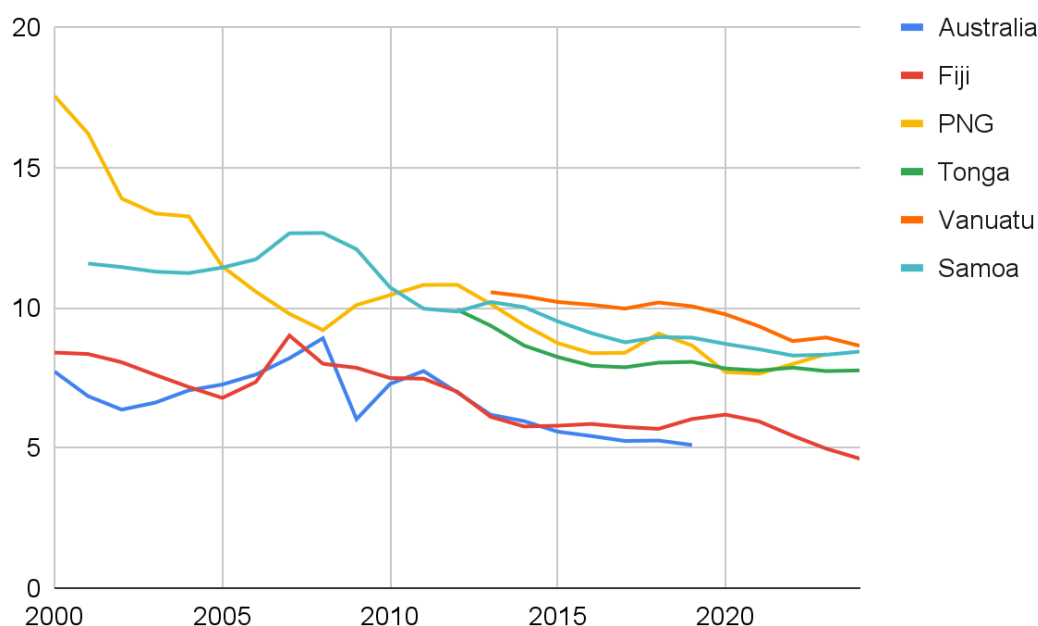
These parameters are critical to the calculations and are discussed in the following subsections.

Borrowing rates

Economic risk and exchange rate risk are higher in the South Pacific than in an advanced economy like Australia, and this flows through to borrowing rates.²² Borrowing rates are significantly higher in the South Pacific economies than in Australia (Figure 2.2). Note that due to differences in terms and conditions that may exist between loan products in different countries, this comparison should be treated as indicative rather than precise. Furthermore, a range of factors influences the borrowing rate, including the creditworthiness of borrowers and inflation expectations.

²² Davies, Matt and John Vaught (2011) Interest Rates and Bank Profitability in the South Pacific, PFTAC Regional Papers, Pacific Financial Technical Assistance Centre, Fiji, p. 2.



Figure 2.2. Borrowing rates for the private sector (nominal), World Bank estimates

Source: World Bank, World Development Indicators. The World defines this borrowing or lending rate indicator as “the bank rate that usually meets the short- and medium-term financing needs of the private sector.”

The Bank of PNG reports that average commercial bank interest rates in March 2025 were 8.22%.²³ In Australia, reported lending rates to businesses vary by loan type, notably depending on whether it is secured or unsecured. Rates range from 5-7% for different types of secured business loans according to RBA data.²⁴

Note that, in Pacific markets, Australian banks are already lending at very competitive rates compared with local banks. According to BSP, ANZ is lending to multinational corporations in the region at 200-250 basis points (bps) below BSP’s rate. This highlights the significant existing funding cost advantage that Australian banks have relative to local banks in the South Pacific.

Based on our review of market data, we conclude that the difference between real interest rates in Australia and PNG and other South Pacific economies could be at least 200 bps or 2 percentage points. This is higher than the emerging market average of 1.4 percentage points, according to a World Bank empirical study, but that would be expected given the significantly higher risks in the South Pacific economies than average emerging market economies.²⁵

²³ Bank of PNG, QEB Statistics Tables, TABLE 7.1: COMMERCIAL BANK INTEREST RATES.

²⁴ RBA statistics, F7 BUSINESS LENDING RATES.

²⁵ Ruch, Franz Ulrich (2021) “Neutral Real Interest Rates in Inflation Targeting Emerging and Developing Economies”, World Bank Policy Research Working Paper 9711,



PBG fee

An additional consideration is that the Australian Government will charge for the PBG. It is unknown at this stage what fee it is charging ANZ and what it would charge other banks that use the PBG.

Previous guarantees by the Commonwealth have charged 70 bps for AA-rated banks like ANZ.²⁶ Incidentally, this was at the low end of other schemes internationally, where the fees originally ranged up to over 150 bps (with Canada having the highest fee).²⁷

The Commonwealth charged much lower rates to the states for its guarantee of their borrowings during the financial crisis. The Commonwealth charged 15-20 bps for existing state debt and 30-35 bps for new debt, depending on the state's credit rating.²⁸

Sensitivity of new lending to the interest rate

The sensitivity of new lending to the interest rate is a critical parameter in the analysis and is subject to a high degree of uncertainty.

IMF econometric research suggests that there could be a significant response of credit demand to lower interest rates in Pacific economies. The IMF economists noted: "for each percentage point change in policy rates, the growth of private sector credit responds by a change of 4-5 percentage points in Fiji, PNG and Vanuatu, 1½ percent in Tonga, and only half a percentage point in Samoa."²⁹ The researchers imply there are concerns over data quality, however.

An experimental study from Mexico found a credit elasticity with respect to the interest rate of -1.4, meaning a one percentage point increase (decrease) in the interest rate reduces (increases) credit demand by 1.4%.³⁰

For the modelling, we have selected a conservative base case for the interest elasticity of -1.5 and an upper bound of -4 based on the IMF study discussed above.

<https://documents1.worldbank.org/curated/en/893151624478783247/pdf/Neutral-Real-Interest-Rates-in-Inflation-Targeting-Emerging-and-Developing-Economies.pdf>, p. 12.

²⁶ Schwartz, Carl (2010) "The Australian Government Guarantee Scheme", RBA Bulletin, March quarter 2010, pp. 20-21.

²⁷ Ibid.

²⁸ <https://www.stateguarantee.gov.au/qa/deposits.html>

²⁹ Yang, Yongzheng, Matt Davies, Shengzu Wang, Jonathan Dunn, and Yiqun Wu (2011) "Monetary Policy Transmission Mechanisms in Pacific Island Countries", IMF Working Paper WP/11/96, <https://www.imf.org/external/pubs/ft/wp/2011/wp1196.pdf>, p. 9.

³⁰ Karlan, Dean and Jonathan Zinman (2013) "Long-Run Price Elasticities Of Demand For Credit: Evidence From A Countrywide Field Experiment In Mexico", Nber Working Paper Series, Working Paper 19106 <http://www.nber.org/papers/w19106>, p. 4.



3.2.2. Substitution from lending that other banks would have done

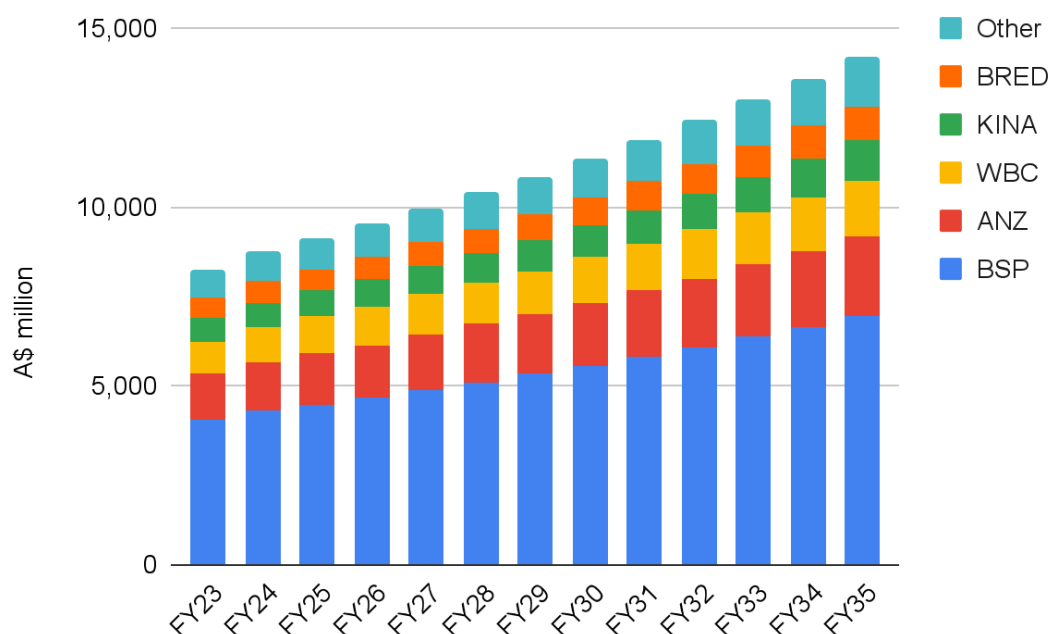
We estimate the substitution from lending that other banks would have done into lending by Australian banks as a residual, after estimating the genuine additional lending and based on our scenarios of expected lending in the region by the Australian banks, which are informed by the parameters of the guarantee to ANZ (refer to 2.3.2).

3.3. Economic modelling results

3.3.1. Baseline

We have defined a baseline scenario in which current market shares are maintained over the next ten years (FY26-FY35). In this scenario, the nominal stock of net lending by banks operating in the South Pacific economies is projected to grow at the expected rate of nominal GDP growth—assuming a 4.5% average growth rate based on our analysis of recent economic growth data and taking account of IMF forecasts (Figure 3.1).³¹

Figure 3.1. Projected stock of bank net lending to business in South Pacific economies



Source: LE modelling based on market data provided by BSP and IMF growth data and forecasts.

³¹Note that gross Lending is the total value of loans issued by the bank, before any deductions. Net Lending is gross lending, minus provisions for loan losses, repayments, and sometimes up-front fees, showing the net amount actually expected to be repaid.



3.3.2. Modelling assumptions and scenario definitions

Due to the uncertainty around how Australian banks will use the PBG, we have modelled three scenarios:

1. **Lower bound**—only ANZ takes up the PBG and uses the guarantee to cover half of its existing corporate lending and the remainder to target additional market share, among other assumptions;
2. **Medium range**—Westpac also takes up the PBG (up to A\$2 billion, like ANZ) and behaves as ANZ does in the lower bound scenario; and
3. **Upper bound**—in which both ANZ and Westpac take up the PBG (with an A\$2 billion cap each), and both Australian banks aggressively target market share, covering none of their existing lending and using the full allocation to pursue new lending.

Given the setup costs involved and their unfamiliarity with the local markets, we think it unlikely that CBA, NAB or any other Australian bank would enter the market. Our full definitions of the scenarios and assumptions are set out in Table 3.1.

Table 3.1. Economic modelling assumptions

Parameter	Lower bound	Medium range	Upper bound
Banks using PBG	ANZ	ANZ, Westpac	ANZ, Westpac
Coverage of existing lending	50%	50%	0%
Years over which \$2bn limit exhausted	10	10	5
Interest elasticity of credit	-1.50	-2.75	-4.00
Savings on borrowing costs (basis points)	130	130	130
Total PGB limit (A\$ million)	2,000	4,000	4,000

We model a situation in which ANZ and/or Westpac expand their lending into the region and lower the cost of finance. There are two effects. One, other banks offering finance at higher prices lose market share to the Australian majors but their lending expands by more than this as their lowering of the price of finance expands demand for finance in the region. The uplift in total lending depends on the interest elasticity of credit and the expected reduction in borrowing rates. This is estimated by assuming the difference in funding costs between local banks and Australian banks is 200 bps, based on reported differences in lending rates between BSP and ANZ. If the Australian banks are assumed to pay a PBG fee equivalent to 70 bps (i.e. what

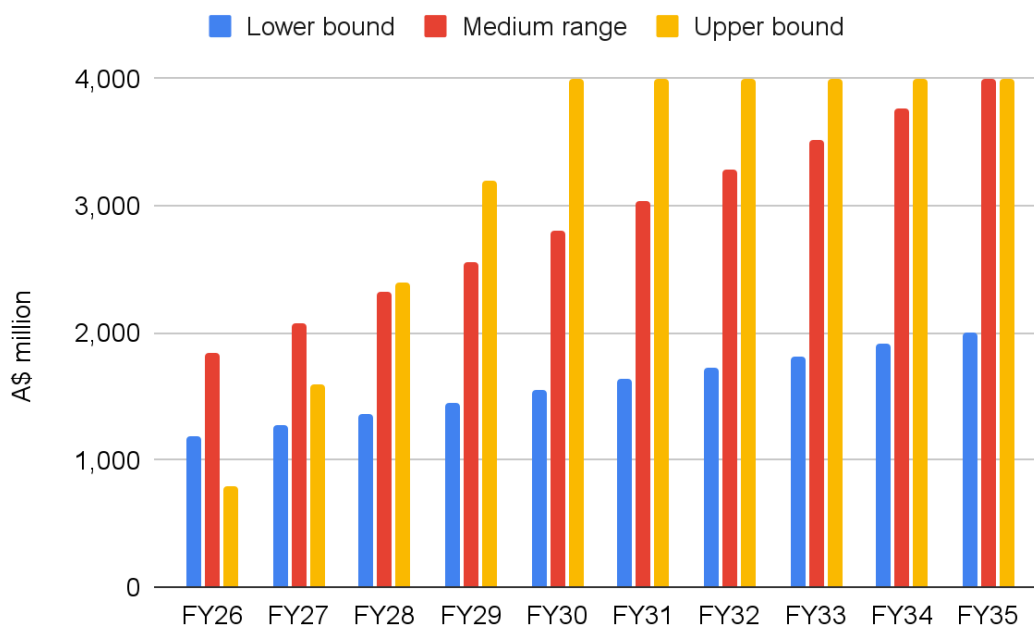


banks paid for the Commonwealth guarantee during the financial crisis), then they could still lend money out 130 bps below local banks (i.e. $200-70=130$ bps).

Regarding the impacts on lending of other banks, the part of ANZ's or Westpac's additional lending that is at the expense of other banks is allocated to the banks according to their shares of total lending in the baseline.

In the three scenarios, we assume different tempos of new lending under the guarantee (Figure 3.2). In the lower-bound and medium-range scenario, the A\$2 billion cap for each bank is reached only after ten years, while in the upper-bound scenario, it is reached after only 5 years.

Figure 3.2. The stock of net lending by Australian banks covered by the guarantee



Source: LE modelling.

3.3.3. Impacts–Market share

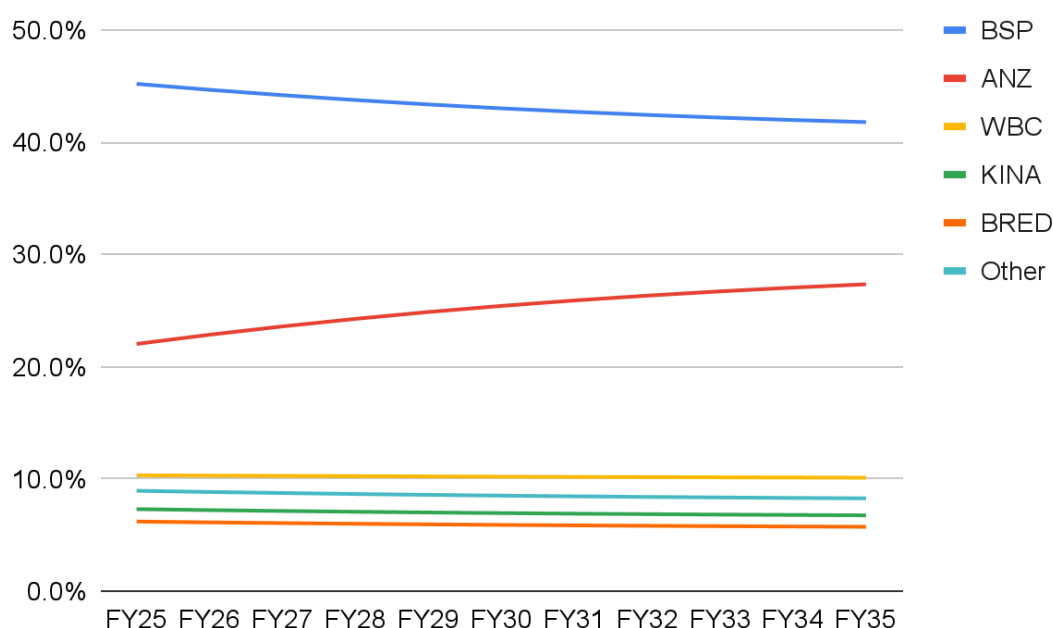
Scenario 1: Lower bound

In Scenario 1, ANZ uses the PGB to increase its market share of the stock of net corporate lending from around 22% to over 27% (Figure 3.3) in the lower-bound conservative scenario. The bulk of the increase in market share to ANZ comes from taking existing business away from other banks, rather than its cheaper lending products adding to the total demand for credit by businesses. The stock of net lending is only 2.0% higher in 2035 relative to the baseline



estimate.³² It is assumed that Westpac maintains its relative market share, and ANZ gains come at the expense of local banks, with BSP losing 3.5 percentage points of market share.

Figure 3.3. Market shares in terms of stock of net corporate lending, Scenario 1–lower bound



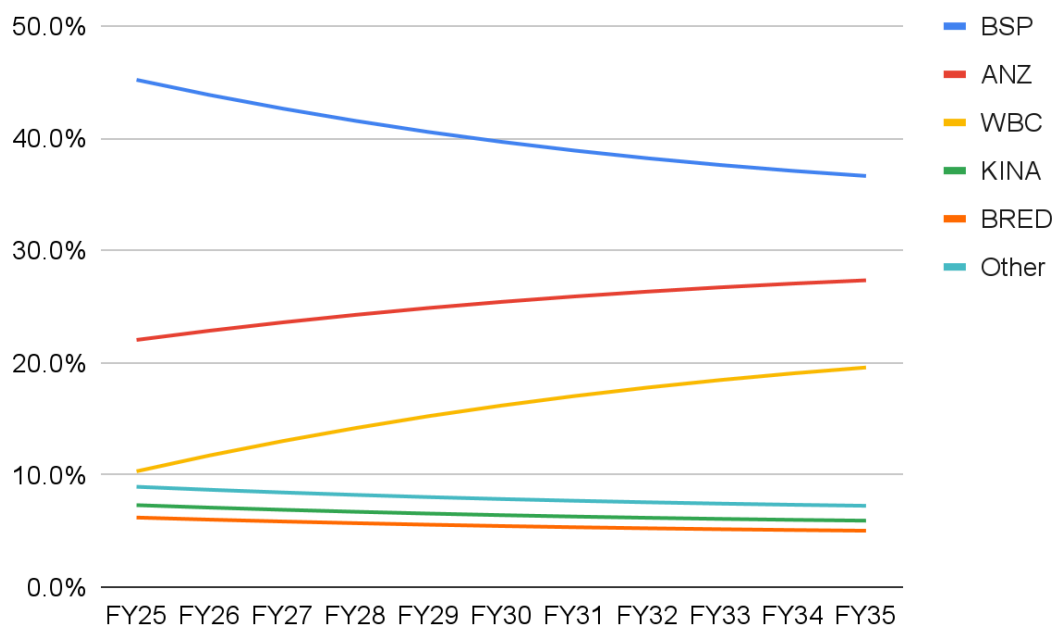
Source: LE modelling. Note that the starting values for market shares are calculated based on the total net lending data in Figure 2.1 and BSP's estimate that corporate lending (mostly loans plus overdrafts) comprises 65% of its loan book. We assume all of ANZ's regional lending is corporate, but the percentage of corporate lending in bank loan books is 65% for the other banks, consistent with the estimate for BSP.

Scenario 2: Medium range

In our medium-range Scenario 2, ANZ and Westpac use the PGB to increase their combined market shares of the stock of net lending by 14.7 percentage points by 2035 (Figure 3.4). BSP's market share falls by nearly 9 percentage points. By 2035, the stock of net lending is 3.6% higher than in the baseline scenario. Again, the vast bulk of the Australian Banks' gains in market share are due to customers switching from other banks.

³² This is modelled according to the formula in section 3.2.1 above. We take the 130 bps saving in borrowing costs and multiply it by assumed interest elasticity of 1.5 (in absolute value) to get $0.013\% \times 1.5 = 2.0\%$. In the modelling, we assume the stock of net lending adjusts incrementally to this new higher level over ten years.



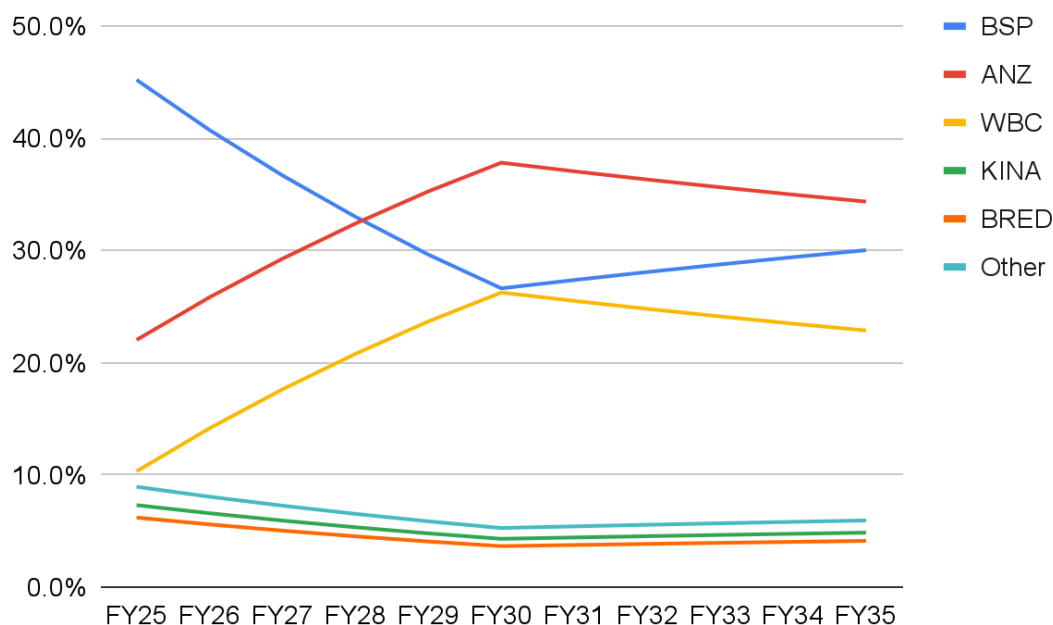
Figure 3.4. Market shares in terms of stock of net lending, Scenario 2–medium range

Source: LE modelling.

Scenario 3: Upper bound

In our upper-bound Scenario 3, ANZ and Westpac use the PGB to increase their combined market shares of the stock of net lending by nearly 25 percentage points (Figure 3.5) by 2035. BSP's market share falls by over 15 percentage points, and it loses its number one position in the market to ANZ (and temporarily also to Westpac). As with the other scenarios, the vast bulk of the Australian Banks' gains in market share are due to customers switching from other banks, rather than additional total lending associated with cheaper credit. By 2035, the stock of net lending is 4.2% higher than in the baseline scenario, which is significantly below the changes in market shares observed. In Scenario 3, because we model the banks using up their \$2 billion of guaranteed lending by 2030, there is a slight recovery in the market shares of the non-Australian banks after 2030. However, their market shares are still well below where they were before the PBG.



Figure 3.5. Market shares in terms of stock of net lending, Scenario 3—upper bound

Source: LE modelling.

3.3.4. Impacts—Financial position of local banks

The loss of corporate net lending to Australian banks will significantly affect the profitability of local banks. LE has estimated this financial impact by taking the reductions in the stocks of the net lending modelled above and applying an assumed net interest margin (NIM) of 150 bps. This assumption is based on reported NIMs for a range of Asia-Pacific banks and is similar to ANZ's recent NIMs.³³ We also assume the loss of a loan origination fee of 50 bps.

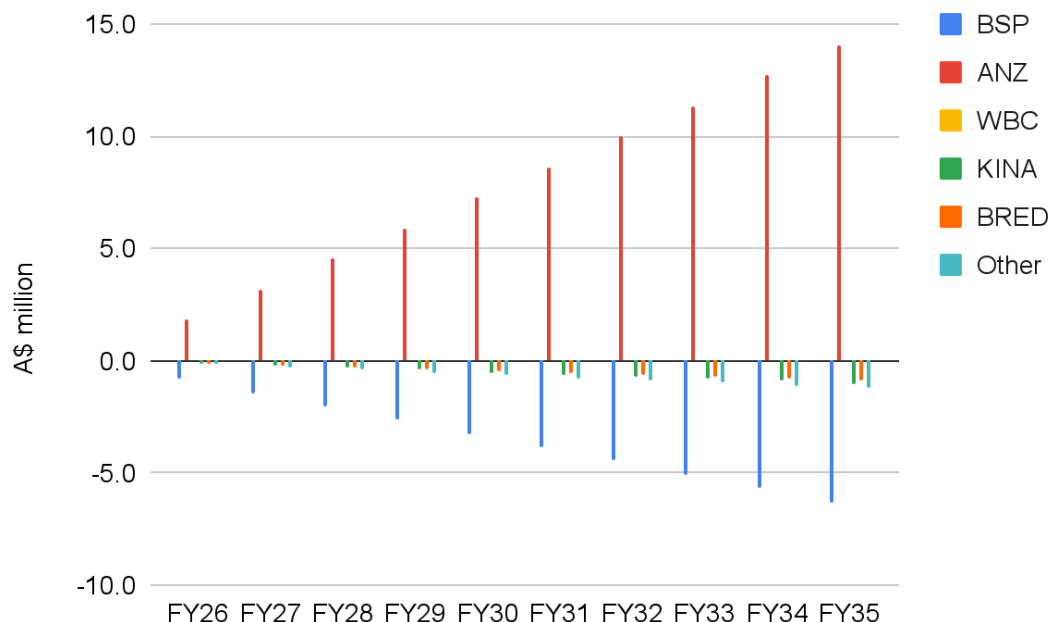
Scenario 1: Lower bound

In the lower-bound Scenario 1, Australian banks increase their profits by approximately A\$79 million over ten years, while non-Australian banks lose A\$53 million due to their loss of market share (Figure 3.6). As discussed above, only a small portion of the gain in market share for Australian banks is related to additional lending relative to the baseline. By 2035, BSP will suffer an annual reduction in earnings of approximately A\$6 million.

³³ Sanglap, Ranina and Marissa Ramos (2024) "Lending income at most Asia-Pacific banks set to decline in 2024", S&P Global, <https://www.spglobal.com/market-intelligence/en/news-insights/articles/2024/6/lending-income-at-most-asia-pacific-banks-set-to-decline-in-2024-82081899>.



Figure 3.6. Financial losses associated with the loss of market share to Australian banks, Scenario 1–lower bound



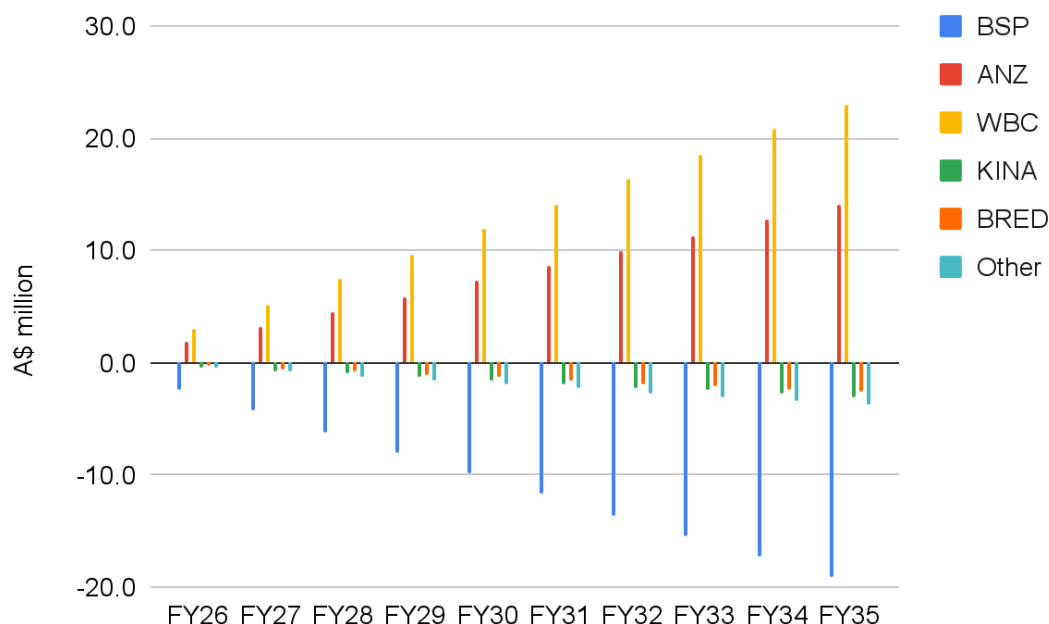
Source: LE modelling.

Scenario 2: Medium-range

In the medium-range Scenario 2, Australian banks increase their profits by approximately \$210 million over ten years. Total losses to the non-Australian banks amounting to around A\$162 million over ten years (Figure 3.7). By 2035, BSP will suffer an annual reduction in earnings of approximately A\$19 million. In Scenario 2, Westpac increases its profits more than ANZ as a result of market share gained from taking advantage of the PBG. This is because, owing to a lower existing market share than ANZ, it uses less of the \$2 billion cap under the PBG to guarantee existing loans, and uses more of it to pursue additional market share than ANZ.



Figure 3.7. Financial losses associated with the loss of market share to Australian banks, Scenario 2–Medium range



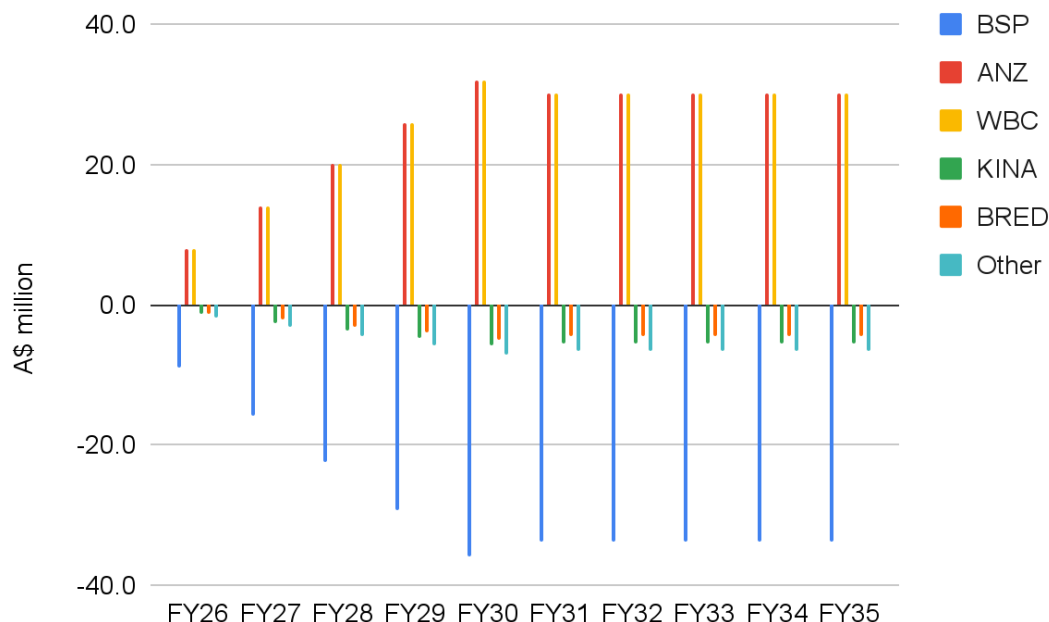
Source: LE modelling.

Scenario 3: Upper bound

In the upper-bound Scenario 3, Australian banks increase their profits by approximately \$500 million while non-Australian banks lose A\$420 million over ten years (Figure 3.8). By 2035, BSP will suffer an annual reduction in earnings of approximately A\$34 million. In Scenario 3, ANZ and Westpac have equivalent increases in profits because both fully use the \$2 billion available under the PBG to pursue market share. In reality, their earnings will differ depending on their relative success competing against each other for corporate business and their underlying costs, among other factors.



Figure 3.7. Financial losses associated with the loss of market share to Australian banks, Scenario 2–Medium range



Source: LE modelling.

Assessment

The loss of market share to Australian banks as a result of the PBG will have significant adverse effects on the local banks. Still, we are in a poor position to assess how it would affect their viability and employment levels without an in-depth analysis of non-publicly available data. An indication of how significant the loss of market share in corporate lending would be can be gained by comparing the expected annual losses with NPAT (Table 3.2). In annual terms, the expected losses are significant, but not existential relative to projected NPAT figures (extrapolated from the 2022-23 figures at the expected rate of nominal GDP growth). That the impacts are not larger in percentage terms reflects the strong financial results in 2022-23 for the local banks (e.g. NPAT of A\$374 million and 21.5% return on equity for BSP) and also our assumption of 1.5% NIM, which may be too low.³⁴ BSP's 2024 Annual Report states an overall NIM of 572 basis points, but it is impossible to reconcile this with the information it has provided regarding its lending rates in section 2 above.

³⁴ BSP (2025) Overview Presentation, p. 10 and BSP (2024) 2024 Annual Report, p. 11.



Table 3.2. Impact on regional NPAT, average over 2026 to 2035

	Lower bound	Medium range	Upper bound
BSP	-0.5%	-1.5%	-3.8%
ANZ	2.7%	2.7%	8.7%
WBC	0.0%	8.4%	16.1%
KINA	-0.7%	-2.0%	-5.2%
BRED	-1.0%	-3.1%	-8.2%
Other	-0.8%	-2.5%	-6.4%

3.3.5. Impacts—Regional governments and wider community

There are also potentially adverse impacts on regional governments and the broader community if the viability of local banks is threatened and they need to reduce their workforces, particularly if their corporate lending operations are cross-subsidising other parts of their businesses. In Section 2, we noted the extensive holdings of government bonds by local banks in PNG in particular. To the extent that the viability of local banks is threatened, a reduction in demand for local government bonds by local banks would result in lower bond prices and higher borrowing costs for the government and most other borrowers whose interest payments are likely to be set by reference to government borrowing rates. However, we have not attempted to model this at this stage.

4. Discussion of policy issues

Apart from its impact on existing South Pacific banks and flow-on effects, the PBG has other undesirable policy aspects, including moral hazard, the current design of the PBG, and its budget implications in the event of defaults.

4.1. Moral hazard

The concern of moral hazard (Box 4.1) is particularly relevant in the context of the Australian Government's Pacific Banking Guarantee, which aims to ensure the ongoing provision of banking services across Pacific Island nations by offering banks protection against potential losses. Although this guarantee plays a critical role in maintaining financial stability and access to essential banking services, it may, as an unintended consequence, lead banks to lend to



higher risk borrowers and/or exercise less stringent due diligence, given their reduced exposure to potential losses.

Box 4.1. Moral hazard in banking

Moral hazard arises when one party engages in riskier behaviour due to the knowledge that another party will bear some or all of the costs associated with these risks. In banking, explicit or implicit guarantees from governments or regulators often create moral hazard by insulating financial institutions from the full consequences of their lending or investment decisions.

A well-known historical example of moral hazard in banking occurred during the U.S. Savings and Loan crisis in the late 1980s. The government-insured deposits through the Federal Savings and Loan Insurance Corporation (FSLIC) provided an implicit guarantee, which encouraged many savings and loan institutions to engage in overly risky investments. When these investments failed, taxpayers bore the substantial costs of the bailout, ultimately totalling approximately \$124 billion.

Another prominent instance was observed during the Global Financial Crisis of 2007-2009. In the years preceding the crisis, large financial institutions such as Lehman Brothers, Bear Stearns, and AIG engaged in excessive risk-taking—particularly through complex financial instruments and subprime mortgage lending—in part because of implicit assumptions of government support. This was overlaid on managers being able to secure bonuses before the costs of their risktaking materialised. The subsequent bailouts of major banks and insurers across the globe reinforced concerns about moral hazard, as financial institutions came to expect public authorities to intervene in periods of distress, potentially weakening incentives for prudent risk management.

These historical episodes underline the critical importance of clearly defined policy boundaries, effective risk-sharing mechanisms, and robust regulatory frameworks to mitigate the inherent moral hazard associated with government-backed guarantees in the banking sector.

Such changes in banking behaviour could lead to broader economic consequences, including inefficient allocation of resources and misdirected investments, potentially weakening economic resilience in the Pacific region. To minimise these risks, it is important to implement clear



boundaries around guarantees, such as limiting coverage levels and adopting risk-sharing mechanisms—e.g. forcing the bank to absorb a fraction of any loss via an excess, as is common in insurance policies. Effective regulatory oversight (including insulating government decision making from political pressures), enhanced transparency, and regular monitoring of the scheme's impacts are also crucial components in mitigating moral hazard.

In sum, while banking guarantees like the PBG are designed to serve economic and social objectives, careful policy design and vigilant oversight are essential to balance the benefits with the potential moral hazard risks they may introduce.

4.2. Guarantee design

There are significant concerns regarding the proposed PBG, specifically the uncapped, open-ended nature of appropriations without a clearly defined end date. Section 5(1) of the *Pacific Banking Guarantee Bill 2025* proposes:

“The Consolidated Revenue Fund is appropriated for the purposes of meeting any liabilities that the Commonwealth incurs under Pacific banking guarantees.”³⁵

While the commitment to ANZ has been capped and is time-limited, there is nothing in the current Bill that ensures this for future guarantees.³⁶ Such provisions expose Australian taxpayers to potential financial risks that have not been adequately quantified or safeguarded against (discussed below). Essential safeguards, including financial caps, defined timelines, and robust oversight mechanisms, would be desirable.

In section 3, we note the uncertainty regarding what the Commonwealth will charge for the guarantee. At a minimum, the PBG legislation should require the Commonwealth to charge a fee that is commensurate with the additional risk taken onto the Commonwealth balance sheet.

The appropriate benchmark for the Commonwealth to charge would be the cost the private sector would charge to bear the risk, since a higher charge would create an unfair playing field for other operators. Given that the Commonwealth can bear risk at a lower cost than the private sector (i.e. due to its greater borrowing power and capacity to bear risk), this would actually generate expected profits for the Commonwealth as it is selling insurance for less than its expected costs of provision. At least *ex ante*, this is a win-win.

³⁵ https://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r7341_first-reps/toc_pdf/25038b01.PDF

³⁶ This was identified by Mr Conaghan MP, Member for Cowper, House of Representatives Hansard, Wednesday 30 July 2025, p. 34.



The remaining question is then ‘why doesn't ANZ go and buy the insurance in the market?’ and presumably the answer is that in a thin market like this, there is significant market failure, and insurers would only be willing to insure the bank’s lending at very high rates.

4.3 Budget impacts

The PBG is attractive to the Commonwealth from a budgetary perspective because the risk is a contingent liability, and it earns some revenue from charging for the guarantee. However, depending on the extent to which the fees reflect the actual risks of guaranteeing the lending, the proposed PBG carries material risks to the Commonwealth government’s balance sheet, given that it would represent an additional contingent liability alongside existing guarantees, such as the Home Guarantee Scheme (HGS), and Australia's already substantial net debt of \$620 billion or 21.5% of GDP in 2025-26.³⁷

Introducing another guarantee expands the government's exposure, potentially straining fiscal capacity in times of economic stress. These risks are magnified by the inherent vulnerabilities in the South Pacific region, particularly in PNG, where political instability, weak governance structures, and susceptibility to economic shocks increase the likelihood of banks requiring financial assistance under the guarantee. Consequently, the government must carefully weigh the strategic benefits of regional financial stability against the fiscal risks associated with compounding contingent liabilities.

There is also a risk that guarantees to foreign institutions may inadvertently delay the emergence of more resilient local credit ecosystems. In development economics, concern has long been expressed about how external supports—whether through aid, concessional finance, or sovereign guarantees—can undermine local institutions’ incentive to build the reputational and informational capital required for robust financial intermediation. Foreign guarantees may thus ‘crowd out’ the development of more creditworthy lending practices by offering artificially low-cost capital to external actors without commensurate accountability to the domestic financial environment. For instance, the OECD has observed that financial guarantees by development banks or donor countries can create “capital market distortions, crowding out other sources of capital in “unfair” ways, and the disturbance to existing market relationships.”³⁸

³⁷ Australian Government 2025-26 Budget Strategy and Outlook, Budget Paper no. 1, p. 341.

³⁸ Winpenny, James (2005) Guaranteeing Development? The Impact Of Financial Guarantees, OECD Development Centre Studies,

https://www.oecd.org/en/publications/2005/10/guaranteeing-development-the-impact-of-financial-guarantees_g1gh5ddf.html.



5. Conclusions

The PBG has significant shortcomings, including its:

1. open-ended appropriation for a broad, uncapped guarantee;
2. lack of a defined fee or articulation of principles by which a fee could be set that is commensurate with the risk the Commonwealth is taking on its balance sheet;
3. adverse impacts on South Pacific banks, which are important contributors to regional economies and significant lenders to regional governments and their economies through their holdings of public debt; and
4. risks to the Australian Government budget, given:
 - a. the South Pacific region has significant economic and social vulnerabilities; and
 - b. the Australian Government already has significant debt and contingent liabilities on its balance sheet.

Hence, LE recommends that, at a minimum:

- the appropriation for the PBG, which only needs to be called on in the event of bad debts, is set at a relatively low amount (e.g. \$100-200 million) to ensure the Commonwealth is prudent in its granting of future guarantees to ADIs;
- it is time-limited, say to ten years;
- there is an excess amount defined, so that Australian banks have to bear part of any losses—an important way to minimise moral hazard, and so, avoid excessive risk taking, and imprudent lending; and
- the Commonwealth is required to charge a fee. That fee should be commensurate with the risk the Commonwealth is incurring, based on independent expert advice prior to entering into guarantees. Given the significantly higher funding costs for Pacific banks relative to Australian banks, this fee should be much higher than previous guarantees to Australian banks, and should be at 100-200 bps.

By tightening up the scope of the PBG, the Government can still achieve its objective of ensuring an ongoing presence of Australian banks in the Pacific, while minimising any adverse, offsetting impacts on regional economies and risks to the Commonwealth balance sheet.



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